

**BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2014-346-WS**

IN RE:)
Application of Daufuskie Island Utility Company, Inc.)
For Approval of a New Schedule of Rates and)
Charges for Water and Sewer Service)

**DIUC’S REPLY TO ANSWER OF ORS TO
DIUC’S PETITION FOR RECONSIDERATION
OF ORDER ON REHEARING**

In its Answer to the Petition for Reconsideration, ORS has doubled-down on the same unsupported adjustments from the original “settlement agreement” and continues to advocate for entry of a ruling that is contrary to the reliable, probative, and substantial evidence in the record will survive on appeal.

As set forth in the Petition for Reconsideration and summarized in this Reply, the evidence requires three changes to the Order on Rehearing to remedy the need for an appeal by DIUC.

- 1. RATE BASE / UTILITY PLANT IN SERVICE**
 - A. ORS Never Identified the Specific Items of Plant Alleged to Support the \$699,631 Adjustment Included in the Order on Rehearing.**

Relying solely on ORS’s inaccurate assertion that Rehearing Exhibit 8 “shows the specific items composing the \$699,361,” the Order on Rehearing excluded from rate base \$699,361 for what the Order calls “gross plant in service representing non-allowable plant, adjustments from

the previous case not carried forward by DIUC in its Application, and asset retirements.” Order on Rehearing at 26. The Order states:

Of the amount deducted, \$699,361 is gross plant in service representing non-allowable plant, adjustments from the previous case not carried forward by DIUC in this Application, and asset retirements. (Id.) **ORS Audit Exhibit DFS-5 (Rehearing Exhibit 8) shows the specific items composing the \$699,361.** (Rehearing Tr. p. 453, ORS Audit Exhibit DFS-5, Rehearing Exhibit 8).

Order on Rehearing at 26 (emphasis added). However, that is not what the Exhibit shows.

A copy of ORS Audit Exhibit DFS-5 (Rehearing Exhibit 8) is attached hereto. Nowhere does the one-page Audit Exhibit DFS-5 identify a single specific item of plant – it only shows the NARUC plant “accounts” identified by a general “description.” In fact, the first column heading of the Exhibit is “Description”. The Exhibit is not a listing of *specific* plant items, it is a listing of *accounts* of plant items. Accounts in this use is a descriptive term for a *category* comprised of hundreds of items; it is not an identification of *specific* items.

The following “Descriptions” from the Exhibit do not identify items of plant – these are *account* descriptions:

- General Plant • Reservoirs and Standpipes • Pumping • Wells
- Meters • Water and Sewer Mains • Treatment • Well Sites

Rehearing Exhibit 8. Hundreds of DIUC’s individual plant *items* are included within these “account descriptions.” However, ORS did not identify anywhere in the record which *specific* items were excluded and ORS did not provide that information in any testimony; therefore, the Order on Rehearing cannot possibly answer the necessary questions, just a few of which are, for example:

What was the specific “Well Site” excluded by ORS for \$1,986 and why?
 How can a “well site” be something that is only worth \$1,986?
 What was the reason for this exclusion?

How did ORS calculate that the “Wells” account should be reduced by \$61,956?
 What pipe(s), equipment, or machinery does that refer to?
 What did ORS exclude each one? Or, did it?

What specific items under the “Pumping” account description were excluded and why?
 Did it include engines?
 Or, was it for piping?
 If it included auxiliary equipment, what equipment?

Which adjustments shown in Rehearing Exhibit 8 were asserted because of documentation issues versus other alleged deficiencies?

None of these questions can be answered by the record because the record does not include any evidence that identifies the specific items of plant that ORS included in the \$699,361 and the asserted reason for excluding that specific item of plant. ORS only identified *accounts*, which is not the same thing as identifying *specific* items of plant, and it did not provide testimony to connect its alleged reasons with its exclusions.

DIUC is not asking for anything that is not required by NARUC. In fact, DIUC’s position is that the Order must be amended in order to conform with NARUC principles of accounting. For example, NARUC’s account description for Pumping Equipment is as follows:

311. Pumping Equipment

This account shall include the cost of pumping equipment driven by electric power, diesel engines, steam engines and hydraulic water wheels and turbines.

A sample of items to be included in this account are listed below:

1. Engines, motors, water wheels and turbines for driving pumps.
2. Pumps, including setting, gearing, shafting and belting.
3. Water piping within station, including valves.
4. Auxiliary equipment for engines and pumps such as oiling systems, cooling systems, condensers, etc.
5. Oil supply lines and accessories.
6. Regulating, recording and measuring devices.
7. Foundations, frames and bed plates.
8. Ladders, stairs and platforms if a part of pumping unit.

NARUC Uniform System of Accounts for Class A Utilities at 103 (excerpted pp. 102-104 attached hereto). “Pumping Equipment” is an account; it is not an item of plant.

The items numbered 1 through 8, are the kinds of *specific* items that ORS should have identified, not just the broad account descriptions shown in Rehearing Exhibit 8 and endorsed by the Order. The broad, general descriptions provided by are not sufficient to respond to the testimony of Mr. Guastella and they are not consistent with NARUC. Certainly, they are not “specific” as the Order on Rehearing asserts. ORS failed to give the Commission a sufficient record. Rehearing Exhibit 8 does not identify specific items of plant, the specific cost of the items being adjusted is not provided, and there is no information about ORS’s reasons for the adjustments.¹ The Order on Rehearing’s reliance on Rehearing Exhibit 8 is misplaced and the Order should be amended to include the \$699,631 within rate base.

B. The ORS Answer Attempts to Make DIUC Responsible for Establishing a Record to Support the Adjustments Proffered by ORS.

DIUC’s Petition for Reconsideration also points out that there was no testimony from ORS in the first hearing or the second hearing to support of the \$699,361 exclusion.

First, it must be made clear that neither Ms. Gearheart’s Exhibit ICG-5 (Hearing Exhibit 18) nor Mr. Sullivan’s Revised Rehearing Audit Exhibit DFS-5 (Rehearing Exhibit 8) identifies the specific items that are tallied to reach the \$699,631 adjustment. Those exhibits only list primary plant accounts; they do not identify items of plant. The ORS adjustments by plant account cannot be identified by or matched with specific items of plant, the specific cost of the items being adjusted is not provided, and there is no information about ORS’s reasons for the adjustments. The excluded amount of \$699,631 was simply repeated by reference to previous ORS witness Ivana Gearheart’s exhibits and a review of Ms. Gearheart’s testimony clearly reveals that Ms. Gearheart failed to itemize the specific assets or costs that are the basis of ORS’s proposed adjustment of \$699,361 to utility plant in service. *See* Hearing Exhibit 18.

¹ The ORS Answer imprecisely refers to testimony of Mr. Gusatella. Mr. Guastella testified that ORS provided work papers that DIUC reviewed and attempted to identify the items the plant ORS used, but DIUC was only able to determine “what we think” the items were. *See* Hearing Tr. at 202.

Petition at 2-3.

The ORS Answer likewise provided no support for the exclusion. Instead, the Answer asserts “If DIUC believed that ORS witness Gearheart’s testimony lacked detail, it had the opportunity to question ORS witness Sullivan.” Answer at 3.

As with the Rehearing Exhibit 8 proffered by ORS witness Sullivan, Hearing Exhibit 18 proffered by ORS witness Gearheart at the original hearing, used the same words like “non-allowable,” “adjustments from the previous case,” or “undocumented.” Ms. Gearheart did not provide any other testimony or analyses to support her adjustments. The Commission cannot determine from Hearing Exhibit 18 or the entire record as a whole what items of plant or what costs were adjusted by ORS as “non-allowable plant.” This circular argument is just another attempt by ORS to divert attention from the lack of any facts in the record to support the proposed adjustment adopted by the Order. DIUC fully addressed the deficiency of the ORS position; it was ORS that failed to properly support its request.

C. The Order’s Adoption of ORS’s Position Regarding Alleged Absence of Contemporaneous Documentation of Costs Violates NARUC Principles.

In his rebuttal testimony at the original hearing, Mr. Guastella provided factual testimony identifying the basis for and justification of the costs included in the \$699,361 of hard assets in service that ORS recommended be disallowed. This testimony addressed the ORS complaint that a portion of the \$699,631 excluded (but not specifically identified) by ORS was excluded because of ORS’s documentation questions.

Mr. Guastella testified as follows, explaining the costs were properly documented by DIUC in compliance with NARUC principles of accounting:

In fact, itemized costs at specific amounts, by primary plant account and the year in service, are recorded on the DIUC's books, which certainly constitute "documentation". The ORS does not claim that the assets in question do not exist and are not used and useful, nor does it question the reasonableness of the amounts that it clearly observed from DIUC's records. Some missing invoices for a relative small portion of plant, particularly for the Melrose Utility Company that essentially abandoned its system, does not constitute an absence of evidence of the reasonable of the utility plant costs for assets that are providing service. Even the Intervenor's expert, Mr. Loy, understands such circumstances.

Hearing Transcript at 203 to 204.

With respect to Ms. Gearheart's claim that some costs were "undocumented," Mr. Guastella and the POAs' expert Mr. Loy both explained to the Commission that Gearheart's position is not consistent with NARUC accounting principles. Because it adopts Gearheart's error, the Order on Rehearing is not consistent with NARUC accounting requirements; it must be amended.

Mr. Guastella's unrefuted testimony explained the proper and NARUC-endorsed role of estimating costs and using estimation studies.

These studies are typically performed when there are no supporting cost records of plant. The NARUC USoA requires an 'estimate' of plant values when there is no supporting documentation available. Original cost studies have been an accepted methodology to establish these values.

Hearing Transcript at 204. The POAs' expert Mr. Loy agreed with DIUC's approach to estimate the plant values. *See* Hearing Transcript at 386 (Loy testifying, "The NARUC USoA requires an 'estimate' of plant values when there is no supporting documentation available.") The only witness in the proceeding that did not know about this proper NARUC accounting requirement was ORS witness Gearheart. *See* Hearing Transcript at 530.

Contrary to the ORS Answer's assertion, there was no need for DIUC to cross-examine the ORS witnesses; the witnesses presented by ORS failed to support their asserted adjustment in the original hearing. On rehearing ORS witness Sullivan merely adopted Gearheart's

unsupported conclusions; he did not provide any additional evidence. At rehearing no one for ORS or Intervenors addressed Mr. Guastella's rebuttal testimony in the primary case regarding these adjustments. No one refuted that Mr. Loy had also endorsed the methods used by DIUC to document its plant.

Again, Mr. Guastella's testimony on these issues was not refuted by any ORS surrebuttal testimony in the primary case and Mr. Loy's agreement with the DIUC estimations also remains unchanged. As such, the record simply does not support the Order's adoption of Gearheart's proposal regarding documentation which is also inconsistent with NARUC principles. The Order must be revised.

D. ORS Failed to Support Its Adjustment to Exclude Capital Costs and Legal Costs Associated with Plant in Service.

The record does not include any ORS testimony in support of excluding capital costs and legal costs associated with plant in service (i.e., the "Land and Land Rights" as shown in Rehearing Exhibit 8) and the ORS Answer fails to remedy this fact. *See* Petition to Reconsider at 6 and Hearing Transcript at 204-206 (exchange addressing why each expense was properly included by DIUC).

The ORS Answer cannot correct the fact that all the evidence in the record about these costs supports only one conclusion -- these costs were incurred by DIUC in the course of managing its property and securing the improvements necessary for providing safe and adequate service to its customers. As such, the Order on Rehearing must allow recovery of these expenses.²

² Denial of these known, actual, incurred costs will unconstitutionally punish DIUC. *See Utils. Servs. of S.C. v. S.C. Office of Regulatory Staff*, 392 S.C. 96, 107 n.8, 708 S.E.2d 755, 761 (2011) (citing *Bluefield Waterworks & Improvement Co. v. Public Service Comm'n of W. Va.*, 262 U.S. 679, 690 (1923) (explaining that where the rates charged by a public utility company "are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the service . . . their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment").

Instead of admitting the lack of support in the record, the ORS Answer merely reports that its witnesses “reviewed the general ledger” and made their calculations. ORS Answer at 3. ORS then complains that DIUC requested an abbreviated rehearing proceeding and admits it did not revisit the testimony of Gearheart or attempt to remedy it. *Id.* at 4. In other words, ORS is again claiming this Commission (and presumably the Supreme Court) should just agree with ORS because ORS said so.³

The complete amount of Utility Plant in Service of \$3,949,956 for water and \$4,189,304 for sewer, or a total of \$8,139,260, as requested by the Application, should be included in the allowance for Utility Plant in Service.

2. ACCUMULATED DEPRECIATION AND DEPRECIATION EXPENSE

DIUC witness Gary White’s direct rehearing testimony presented DIUC’s rate analysis and supporting schedules in Exhibit GCW-R1, which includes proposed accumulated depreciation in the amount of \$429,396 for water and \$348,458 for sewer, and depreciation expense of \$42,120 for water and \$ 53,420 for sewer, net of the annual amortization of CIAC. Mr. White’s prefiled rehearing rebuttal testimony addressed ORS witness Sullivan’s depreciation amounts for both accumulated depreciation and depreciation expense, pointing out several inconsistencies in the ORS testimony. *See* Rehearing Transcript at 126 to 130. In that testimony, Mr. White observed that Mr. Sullivan’s depreciation schedules are in conflict with DIUC’s book figures, there are no known and measurable changes after December 31, 2014, and his roll forwards are not consistent

³ This is the precise position that the Supreme Court questioned during oral argument. The Justices questioned whether ORS was asserting that the Commission’s review and the Supreme Court’s review of ORS analysis are unnecessary because ORS knows best, regardless of what the evidence indicates. *See* Video Archive of Supreme Court proceedings in this matter on December 14, 2016, available online at <http://media.sccourts.org/videos/2016-000652.mp4> (beginning at Minute 23:30 and following).

with ORS's position in the 2011 rate case as to plant in service, accumulated depreciation and average service lives. *Id.* Mr. White also provided a detailed roll forward of depreciation expense and accumulated depreciation in Exhibit GCW-R2.

In his surrebuttal testimony, Mr. Sullivan states that he focused on the issues from the Supreme Court decision and given the limited time in this rehearing process, he did not undertake further reviews of DIUC's books and records, the ORS position in the 2011 rate case, or the positions reflected in Ms. Gearheart's work in this docket. *See* Rehearing Transcript at 459. So, Mr. Sullivan's testimony does not constitute substantial evidence for rejecting Mr. White's depreciation recommendations.

In an attempt to save its position, the ORS Answer characterizes the issue as one of conflicting evidence. *See* Answer at 4 (citing *S. Bell Tel. & Tel. Co. v. Pub. Serv. Com.*, 270 S.C. 590, 597, 244 S.E.2d 278, 282 (1978) for the proposition that "A mere conflict between two sets of evidence does not prove that one set is not substantial."). However, there is no conflicting evidence here; ORS has provided nothing to contradict Mr. White's analysis.

Mr. White provided Exhibit GCW-R2 (Rehearing Exhibit 3) and specifically testified that "DIUC's calculation of accumulated depreciation has been consistent; it reflects proper regulatory accounting; and it makes the appropriate known and measurable adjustments." Rehearing Transcript at 130. The Commission should reconsider its Order and accept the detailed depreciation analysis provided by Mr. White.

3. RATE CASE EXPENSE

For the first time on rehearing ORS argued to this Commission that DIUC's incurred costs for work performed by Guastella Associates over the three years of this proceeding should now be completely disregarded because ORS's new witness on rehearing, Dawn Hipp, did not approve of

the form of the invoices. *See* Rehearing Transcript at 476.

The majority of the ORS Answer is devoted to circular arguments and back-peddling that attempts to distract the Commission from ORS's "gotcha" tactics and punitive measures. The ORS Answer then brazenly offers its condolences to DIUC for this situation by offering the excuse that ORS had "little time in which to review ... rate case expenses." Answer at FN#9. Then, as if that was not enough, the ORS Answer specifically blames DIUC for the necessity of a condensed rehearing schedule when it was ORS who set this entire proceeding upside down when it signed on to a "settlement agreement" in a back-room deal with the POAs resulting in an appeal and reversal, none of which was in any way DIUC's fault.

To recap, ORS asks this Commission adopt the following logic:

- It is acceptable for ORS to propose a wholly unsupported "settlement agreement" endorsing rates that will bankrupt a utility.
- In order to then survive, a utility can certainly pursue and pay for an appeal to correct ORS's mistakes and then pay for all that is encompassed in a rehearing to correct the blatant errors of ORS.
- But, when the ORS positions requiring the appeal, reversal, and rehearing actually prove to be causing the precise financial disaster predicted by the utility and the Supreme Court in reversal, ORS is not responsible to respond in a timely manner on rehearing. Also, ORS will fault the utility if it requests expedited review for financial reasons. *See* Answer at FN#3, FN#6, page 7, and page 8 (twice) for criticism of the "abbreviated" schedule that DIUC "requested" thereby creating "self-imposed hardship."
- Instead, ORS always needs at least "a normal rate case period of 6 months" to fully analyze any changes brought about by an appellate decision. *See* Answer at 8.
- And further, on remand ORS can introduce for the first time new reasons for excluding rate case costs that were already reviewed by ORS in the original hearing process. In other words, if a utility successfully appeals a deal ORS supported then on remand the utility should be prepared for ORS to come up with brand new reasons for excluding the costs incurred by the utility.

- And finally, if ORS is successful in arguing its new reasons to limit recovery of rate case expenses, the utility will just have to carry all of its expenses (in this case over \$800,000) until the next rate case when ORS *might* have more time to actually review the issues in the case and ORS *might* be able to engage in its usual “back and forth” with the utility about how to gain ORS approval for recovering its actual, documented expenses.

This Commission cannot allow the ORS position as to rate case expenses or this kind of “gotcha” game with utilities continue, especially when the stakes at issue are hundreds of thousands of dollars – most of which in this instance were expended by DIUC to remedy a settlement deal that ORS backed, even when there was no evidence that DIUC could financially survive its terms.

ORS admits it did not allow DIUC to provide additional information about the rejected \$542,978 and that ORS usually engages an applicant to allow additional information to be provided in response to ORS questions about verification of charges or invoices. *See* Petition for Reconsideration at 13-14 (citing Rehearing Transcript at 520). DIUC is being punished for its appeal and then blamed because it could not afford to wait 6 more months before collecting adequate rates.

Finally, while DIUC appreciates that the Order on Rehearing permits DIUC an opportunity to pursue the \$542,978 of requested rate case expenses in a future rate proceeding, not allowing DIUC to recover any of the \$542,978 in this case (not even a modest amount that has been clearly supported by evidence) is contrary to the basic standards of cost recovery and rate setting principles. Furthermore, deferral improperly requires DIUC to bear the burden of carrying these costs beyond a reasonable period of time resulting in a punitive impact on DIUC.

A. The Order on Rehearing improperly excludes \$542,978 of Guastella Associates billings from rate case expense.

In support of excluding \$542,978 of Guastella Associates billings from rate case expense, the ORS Answer does not provide any more insight than the testimony already provided by ORS

witness Dawn Hipp and the asserted criteria that ORS raised for the first time just days before the hearing on remand, more than three years after the initiation of this rate proceeding. The Petition for Reconsideration addresses all the last minute complaints and explains why an amended Order is necessary.

The ORS Answer to the Petition for Reconsideration does attempt to resurrect a shaky ORS assertion that the total requested rate case expenses are not presumed to be valid. That is just not correct.

A utility in a ratemaking proceeding is “entitled to a presumption that its expenditures were reasonable and incurred in good faith.” *Utils. Servs. of S.C. v. S.C. Office of Regulatory Staff*, 392 S.C. 96, 109, 708 S.E.2d 755, 762 (2011). “This presumption does not shift the burden of *persuasion* but shifts the burden of *production* on to the Commission or other contesting party to demonstrate a tenable basis for raising the specter of imprudence.” *Id.* (emphasis added) DIUC is entitled to this presumption with regard to its rate case expenses because the record contains nothing to suggest the Guastella Management Agreement is in any way improper.

Mr. Guastella testified at length about the management agreement and how it was negotiated:

Our management fee was an arm’s length negotiation ... when the CK Materials people were thinking about acquiring the utility from International Paper, they came to me and asked if I would help them with that acquisition.

[...]

[O]nce I helped them with the acquisition, I was asked whether or not I would then manage the utility, because they really didn't know how to do that. So I entered into an arm's length agreement ... that includes all the duties and functions that Guastella would perform on a day-to-day basis.

Hearing Transcript at 154-155. Also included within the Guastella Management Agreement is a separate provision whereby activities that would normally involve outside consultants, like system

appraisals and rate case filings, would be addressed by the parties separately. *See* Hearing Exhibit 9. The record reflects that is what occurred here.

At rehearing Mr. Guastella testified the agreements between GA and DIUC are consistent with reasonable industry standards, the fees charged are consistent with reasonable industry standards as to the calculation method of those fees. *See* Rehearing Transcript at 251-252. Although Mr. Guastella does serve on the DIUC Board, the corporation itself made its initial decision to enter into the management agreement with Guastella Associates before he was on the Board. Rehearing Transcript at 253. When the GA Agreement was renewed in 2015, the record demonstrates each of the members of the Board of Directors made their own independent decision about renewal, without Mr. Guastella's participation or influence. Rehearing Transcript at 255.

There is nothing in the record to dispute this testimony or to provide even an arguably tenable basis for raising the specter of imprudence. *See Utils. Servs. of S.C. v. S.C. Office of Regulatory Staff*, 392 S.C. 96, 109, 708 S.E.2d 755, 762 (2011). As such, DIUC is entitled to (and the Commission erred in failing to apply) the presumption that the GA rate case expenses of \$542,978 are reasonable and incurred in good faith as required by law.

The ORS position that somehow it cannot verify a single hour of the work of GA personnel in this incredibly long rate case (necessitated, again, by ORS's misguided actions in the first hearing and on appeal) is not credible. The ORS criticisms of the invoices in no way negate the work performed by GA. There is no testimony in the record that the extensive rate case work was not performed by GA or that it was unnecessary.

The reliable, probative, and substantial evidence demonstrates the significant amount of work performed by GA for DIUC in these rate proceedings and the Commission should allow DIUC to recover the \$272,382 granted in the Order on Rehearing for rate case expense incurred

through September 30, 2017 and also allow DIUC to recover \$269,356 for GA fees incurred through September 30, 2017 for a total of \$541,738 in rate case expenses over three years collected annually at \$180,579.

CONCLUSION

For the foregoing reasons, DIUC requests the Commission reconsider the Order on Rehearing and enter an amended order including the \$699,361 of utility plant in service, revising the depreciation as set forth herein, and allowing DIUC to recover an additional \$269,356 for rate case expenses by Guastella Associates incurred through September 30, 2017.

Respectfully submitted,

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March 15, 2018
Charleston, South Carolina

CERTIFICATE OF SERVICE

This is to certify that on March 15, 2018, I caused to be served upon the counsel of record named below a copy of the foregoing **DIUC'S REPLY TO ANSWER OF ORS TO DIUC'S PETITION FOR RECONSIDERATION OF ORDER ON REHEARING**, by electronic mail, as indicated.

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